No. 85-773

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Supreme Court of the United States

October Term, 1985

ATLANTIC RICHFIELD COMPANY; ARCO PIPE LINE COMPANY; EXXON CORPORATION; EXXON PIPELINE COMPANY; BP ALASKA, INC.; SOHIO ALASKA PETROLEUM COMPANY; and SOHIO PIPE LINE COMPANY,

Appellants,

vs.

STATE OF ALASKA, *et al.*,

Appellees.

On Appeal From the Supreme Court of Alaska

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QUESTIONS PRESENTED

1. In light of this Court's decision in *Exxon v. Wisconsin*, 447 U.S. 207 (1980), that separate accounting may not be used to assign the production income of a unitary oil business to the state of production, but that such income is properly subject to apportionment among all states where the unitary business operates, may Alaska attribute all of such production income to itself without violating the Commerce and Due Process Clauses?

2. In light of *J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307 (1938), *Evco v. Jones*, 409 U.S. 91 (1972), and other decisions of this Court holding that a state may not, without apportionment, levy a tax on 100% of the income resulting from interstate sales, do the Commerce and Due Process Clauses permit Alaska to attribute to itself for taxation, without apportionment, 100% of the income appellants earn by selling crude oil from Alaska in other states?

3. In light of this Court's decisions in *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123 (1931), and later cases that a state may not tax income out of all appropriate proportion to the business transacted in the state, did the Alaska court err in ignoring appellants' evidence of disproportionate taxation, including a showing that appellants were overtaxed in amounts ranging from 279% to 804%?

4. Is the Oil Tax permissible in light of this Court's decision in *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978), given that the Oil Tax produces multiple taxation and that the multiple taxation is the constitutional fault of Alaska because: (a) the Oil Tax is unapportioned; (b) the Oil Tax is tailored to interstate commerce; and (c) Alaska's taxes fail the constitutional requirement of internal consistency?

5. Is the measure of Alaska's Oil Tax reasonably related to a taxpayer's contacts with the state, as required by this Court's decision in *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981), where the tax is measured by income,

but the amount of tax does not vary as income-earning activities are shifted into or out of Alaska?

6. Does Alaska's Oil Tax discriminate against interstate commerce by conferring a direct commercial advantage on residents of Alaska, or deprive appellants of the equal protection of the laws, because the Oil Tax (a) enables Alaska to collect 95% of its revenues from one interstate business while freeing Alaska's citizens from any direct monetary contribution to their government; (b) gives Alaska firms a continuing tax advantage over non-Alaska firms; and (c) artificially channels oil exploration into Alaska by imposing a tax penalty on firms that choose to drill in other states?

PARTIES

The Alaska Department of Revenue, the Alaska Commissioner of Revenue, and the Alaska Commissioner of Administration were parties in the court below. A list of appellants' subsidiaries and affiliates is given in the Appendix.

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October Term, 1985

ATLANTIC RICHFIELD COMPANY, *et al.*,

Appellants,

vs.

STATE OF ALASKA, *et al.*,

Appellees.

On Appeal From the Supreme Court of Alaska

This appeal is from the final judgment of the Supreme Court of Alaska, dated August 16, 1985, upholding Alaska's Oil & Gas Corporate Income Tax, AS 43.21 ("the Oil Tax"), as against appellants' claims that as applied to them the Oil Tax is (1) repugnant to the Commerce Clause of the United States Constitution, and (2) deprives them of due process of law and of the equal protection of the laws.

OPINIONS BELOW

The opinion of the Supreme Court of Alaska, App. 2a, is reported at 705 P.2d 418 (1985). The opinion of the Alaska Superior Court is not reported. App. 45a.

JURISDICTION

The final judgment of the Supreme Court of Alaska, rejecting appellants' claims that the Oil Tax was unconstitutional, was entered on August 16, 1985. App. 2a. Notice of Appeal to this Court was duly filed in the Supreme Court of Alaska on November 6, 1985. App. 49a. This appeal is being docketed within 90 days from the entry of judgment below. Jurisdiction of this Court rests on 28 U.S.C. § 1257(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS

U.S. Const., Art. I, § 8, cl. 3:

> "The Congress shall have Power . . . to regulate Commerce . . . among the several States. . ."

U.S. Const., Amend. XIV, § 1:

> "nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

Oil & Gas Corporate Income Tax Act, AS 43.21:

> The text of the Oil Tax is set forth in the Appendix, together with the relevant Regulations (15 AAC 21).

STATEMENT OF THE CASE

Appellants are the principal owners of the Prudhoe Bay oil field on the North Slope of Alaska, and of the Trans Alaska Pipeline. Oil was first discovered at Prudhoe Bay in 1968. From 1968 to 1978, appellants spent in excess of $15 billion to build the pipeline and develop the oil field. R. 13369, 14163-64.*

While appellants were incurring these huge expenses in Alaska, and before any oil flowed from the North Slope, Alaska taxed the income of all corporations, including appellants, by the method used by most states — three-factor apportionment. R. 12844-88; 13749-53. The effect of Alaska's pre-1978 apportioned tax system was to attribute substantial profits to Alaska for taxation, although any focus on appellants' activities in Alaska alone would have shown

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*The facts in this section are taken from the more than 4000 pages of affidavits and exhibits appellants filed in the Alaska Superior Court. Since this is an appeal from the grant of summary judgment, the facts set out in those affidavits must be taken as true under Alaskan (as under federal) law. Braund, Inc. v. White, 486 P.2d 50, 54 (Alaska 1971).

Emphasis is supplied throughout except where otherwise indicated. The operation of the Oil Tax is generally described in the present tense although, as discussed *infra*, it was repealed in 1981.

heavy losses. R. 253, 292, 12697. Throughout the period when apportionment worked to Alaska's advantage, Alaska insisted on taxing oil companies by apportionment. *State v. Amoco Production Co.*, 676 P.2d 595 (Alaska 1984).

Things changed in 1977 when oil began to flow from the North Slope and through the Trans Alaska Pipeline. Effective January 1, 1978, Alaska enacted Alaska Statute ("AS") 43.21, the Oil and Gas Corporate Income Tax ("the Oil Tax"), and changed its tax system as applied to appellants. Unsurprisingly, the new system produced vastly larger revenues for Alaska than would have been generated by the pre-1978 system of taxation by apportionment.

During the four years in issue here (1978-81), the Oil Tax resulted in payments to Alaska by these taxpayers of approximately $2 billion. R. 16153. By 1981, 95% of Alaska's revenues came from the oil industry, and 83% from these taxpayers *alone*.[1] Passage of the Oil Tax allowed Alaska to repeal its personal income tax, repeal its school tax, repeal its gross receipts tax, reduce the tax rates on local businesses, and adopt a program to pay each resident a cash dividend every year, starting at $1,000 per person. R. 12919. As Alaska noted in its 1981 Financial Report, "the citizens of Alaska no longer make a direct monetary contribution to the cost of state government." R. 13126.

The Oil Tax has three main features.

First, the Oil Tax attributes to Alaska 100% of appellants' interstate *production income*. AS 43.21.020. This is the net income appellants earn by selling, in the Lower 48 states, crude oil that comes from Alaskan wells. The catch is that appellants' income from selling that oil is also subject to tax, and is taxed, in the Lower 48 states as well. R. 13448-49,

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[1]App. 182a. When it enacted the Oil Tax, Alaska projected that in 20 years its oil taxes would result in a state surplus, over and above all projected expenditures, of $184 *billion* — a jackpot of $450,000 each for every man, woman, and child in Alaska. Alaska Executive Budget (Operating), FY 1981, at 14, Col. 7, line 20. Amassing that sum would have involved a transfer of wealth from the Lower 48 to Alaska equal to $1,000 for every American. The truly remarkable fiscal and economic consequences of Alaska's overreaching oil tax policy are described in detail in the Mieszkowski Affidavit, App. 172a.

13744, 14247-48. Alaska's attribution of 100% of that income to itself thus inevitably produces double taxation.

Second, the Oil Tax attributes to Alaska 100% of appellants' *pipeline income*. AS 43.21.030. This is the net income appellants earn from pipeline transportation of Alaskan oil. The Oil Tax also results in double taxation of pipeline income, since appellants are unitary businesses and pipeline income is subject to tax, and is taxed, in the Lower 48 states as well as in Alaska.[2]

Third, in contrast to its treatment of production and pipeline income, the Oil Tax retains three-factor apportionment in order to attribute to Alaska a share of all of appellants' *other income*. AS 43.21.040. This income is primarily from refining and marketing operations. Since appellants have neither refineries nor retail gas stations in Alaska, this branch of the Oil Tax snares for Alaska taxation profits that have no connection to Alaska other than the fact that appellants are unitary businesses.

The production and pipeline income that Alaska taxes is the result of activities in all states, not only Alaska. Approximately 90% of the crude oil from Alaskan wells is sold, not in Alaska, but in the Lower 48. App. 294a, 335a; R. 13225, 13414, 12692-93. The capital to develop the Prudhoe Bay field and build the pipeline came almost exclusively from outside Alaska. R. 13369-75, 13670-75, 14164-70. The technology that made possible production of oil under Arctic conditions was developed outside Alaska. R. 13559-67. Operation and management of the Prudhoe Bay oilfield and the pipeline is the responsibility of thousands of appellants' employees, some of whom are located in Alaska but many more of whom work in California, Ohio, Texas, and elsewhere. R. 13219-14202; see App. 291a-367a. The record includes an estimate that no less than 80% of the expenses

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[2]Since the issues as to pipeline income are generally similar to those affecting production income, for convenience this Jurisdictional Statement analyses the issues in terms of production income. See App. 6a.

necessary to earn production income from Alaskan oil were incurred *outside* Alaska. App. 285a.

Despite the out-of-state contributions that make possible the earning of production income, the philosophy of the Oil Tax is to attribute to Alaska all production income appellants earn by selling crude oil from Alaskan wells. The Oil Tax does this by defining "net production income" as equal to the sales price of crude oil at the refinery inlet in the Lower 48, less the costs of extracting that oil and the costs of shipping it from the North Slope to the point of sale.[3] All net production income is attributed to Alaska by the Oil Tax. App. 5a-6a. The Oil Tax makes no effort to ascertain what part of that net production income is attributable to the contributions of Alaska, as the state of origin, and what

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[3]The Regulations take a fairly circuitous route to accomplish this result. "Taxable production income" is defined as "gross production revenue" less "deductions under 15 AAC 21.200-15 AAC 21.290." 15 AAC 21.100. "Gross production revenue," in turn, is defined as "value at the point of production" of the oil produced, 15 AAC 21.110, and "value at the point of production," in turn, is defined as the "sales price" less "reasonable costs of transportation" from the "point of production to [the] sales delivery point." 15 AAC 21.120.

"Sales price" is defined in 15 AAC 21.122. In general, the sales price is the "cash value of the full consideration being given in receipt for that oil." 15 AAC 21.122(a). If the oil is sold to an affiliate of the taxpayer, or if it is transferred from one division to another, the transfer price shown on the taxpayer's books is treated as the sales price. 15 AAC 21.122(b), (c). (Since the Oil Tax treats as sales transfers of oil from one division of a taxpayer to another, such transfers are included as "sales" herein.) From the sale price of the oil, "reasonable costs of transportation" are deducted in order to arrive at gross production revenue. 15 AAC 21.110, 21.120. Transportation costs are to be calculated "from the point of production to the sales delivery point." 15 AAC 21.130(a). The Oil Tax also permits deduction of certain other costs from gross production revenue in arriving at net production revenue. 15 AAC 21.200.

It is of interest to notice that although the term "value at the point of production" is used in the Oil Tax Act and the Regulations, in the practical operation of the Oil Tax it represents (as the Alaska Court conceded, App. 6a) nothing more than the mathematical result of subtracting transportation costs from the Lower 48 sales price. 15 AAC 21.120. The record shows without dispute that there is not a market for crude oil on the North Slope, and therefore that there can be no market price at the wellhead. App. 264a-265a, 308a. "Value at the point of production" is thus merely a construct. It has no role to play in the statutory scheme except to obscure momentarily the fact that Alaska's calculation of "taxable production income" actually begins with the price for which the crude oil is sold in the Lower 48.

part is attributable to the contributions of the states of sale and of the other states where the activities took place that made possible the extraction of Prudhoe Bay oil. The Oil Tax makes no effort to divide net production income among those states; it asserts that *all* of it belongs to Alaska.[4]

In this context it is important to notice that the deductions allowed by the Oil Tax are deductions only for *costs*. Despite the suggestion to the contrary in the opinion of the Alaska court, App. 10a-11a, this does not mean that the tax is in any way apportioned. It means only that the Oil Tax is a tax on net income, not on gross receipts. *By definition*, a net income tax allows deductions for costs; the relevant point is that the Oil Tax makes no effective allowance for the fact that some of the profits — i.e., the *net* income — it taxes are earned outside Alaska. Whether profits from the production and sale of crude oil originating in Alaska are earned inside Alaska or outside, they are treated as "Alaska" income and attributed 100% to Alaska.[5]

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[4]Because appellants, as the Alaska court found, App. 15a. are functionally integrated unitary businesses, it is difficult or impossible to measure with confidence the exact contributions of the various states. That is why apportionment formulas are used to tax unitary business income. See, e.g., Mobil v. Vermont, 445 U.S. 425, 438 (1980); F. W. Woolworth Co. v. Taxation and Revenue Dept., 458 U.S. 354, 364 (1982). The record, however, includes a number of dramatic examples of how the Oil Tax has attributed to Alaska substantial income that manifestly was earned outside the state. For example, Sohio's marketing department, operating from Cleveland, was able to secure a Virgin Islands refiner as a customer for millions of barrels of Alaskan oil. Because the Jones Act does not apply to shipments to the Virgin Islands, Sohio's transportation costs for this oil were $2 per barrel less than if the oil had been shipped by American flag tanker; Sohio's income was correspondingly greater. R. 13417-18. This additional $2 per barrel has absolutely nothing to do with Alaska, but the Oil Tax attributes 100% of it to Alaska. Or again, Arco, operating from California and Texas, carried out a project to reverse the so-called "Line 90" pipeline that had been built to carry oil from New Mexico to California, thus reducing the cost of transporting Alaska crude to refineries in the mid-continent states. This decrease in Arco's cost of transportation was made possible solely by a pipeline in the Southwestern Desert. Yet the Oil Tax treats that decrease as income and allocates every penny of the additional profit to Alaska. R. 13075, 13637-38.

[5]To this rule there is only one exception, and it is apparent rather than real. In 1982, the Department of Revenue issued a regulation that pretended to allow deduction of profits on overhead. The regulation, however, was designed so no taxpayer could take advantage of it. See pp. 16-17, infra.

The Oil Tax was in effect for only four years. Following the institution of this litigation, and based on the legal advice it was given, the Alaska Legislature recognized that appellants' challenges to the Oil Tax were substantial. R. 10539-40. In 1981, accordingly, it repealed the Oil Tax and replaced it with a modified apportionment formula. 1981 SLA Ch. 116. Despite the repeal, the Legislature is actively considering a bill to reimpose the tax, or something very similar, if it is not ruled unconstitutional. House Bill 353.

HOW THE FEDERAL QUESTIONS WERE RAISED

Appellants raised each of the questions presented (except Question 6(c)) in their amended complaints and counterclaim, R. 241, 273, 12690,[6] in their memoranda in opposition to Alaska's successful motion for summary judgment, R. 12718-839, 17150-70, and at pages 19-76 of their brief in the Alaska Supreme Court. Question 6(c) was raised at pages 59-62 of appellants' Reply Brief in the Alaska Supreme Court, filed July 13, 1984. It could not have been raised earlier, because it depends on an interpretation of Alaska law first announced by the Department of Revenue on April 27, 1984. App. 420a-421a.

THE QUESTIONS ARE SUBSTANTIAL

This case involves Alaska's attempt to arrogate to itself *all* the net income that results when crude oil from Alaskan wells is sold in the Lower 48 states, even though that income results entirely from interstate sales and is subject to tax, and is taxed, by many states besides Alaska. Although Alaska concedes that appellants are unitary businesses, App. 15a, R. 14836, Alaska has abandoned the method — apportionment — that virtually all states use to tax unitary businesses, R. 13213, and has adopted a tax system tailored

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[6]This litigation was commenced on March 22, 1979 by the filing of a complaint by Arco and Sohio challenging the Oil Tax on the grounds that it was repugnant to the Commerce, Due Process, Equal Protection, and Contract Clauses. R. 196. Alaska later sued Exxon, praying for a declaration that the Oil Tax was constitutional. R. 1. In 1980, the cases were consolidated, Arco and Sohio filed amended complaints, and Exxon filed a counterclaim. R. 241, 273, 12690.

to maximize revenue from Alaska's principal export, and to enrich Alaska at the expense of the rest of the country.

The legal questions presented in this case are undoubtedly substantial. The Oil Tax violates each of the tests this Court has set forth to detect impermissible overreaching by a state: it is unapportioned; it causes multiple taxation; it discriminates against interstate commerce; it taxes extraterritorially; and it is internally inconsistent. The judgment below is inconsistent with *Exxon v. Wisconsin,* 447 U.S. 207 (1980), *Mobil v. Vermont,* 445 U.S. 425 (1980), *Japan Line, Ltd. v. County of Los Angeles,* 441 U.S. 434 (1979), and *J.D. Adams Mfg. Co. v. Storen,* 304 U.S. 307 (1938). It is also contrary to principles to which this Court has adhered for eighty years which forbid unapportioned taxes and prevent multiple taxation of interstate commerce.

The questions in this case are also of great public importance because they involve the constitutional limits on Alaska's taxation of income earned from crude oil produced on the North Slope of Alaska. That oil, this Court has already said, is a "resource of profound *national* importance." *Hicklin v. Orbeck,* 437 U.S. 518, 533-34 (1978). Oil production at Prudhoe Bay is almost exclusively the product of *interstate* commerce. For 150 years, this Court has interpreted the Commerce Clause as prohibiting states from imposing taxes that disproportionately burden interstate commerce. Alaska, however, has succumbed to the temptation of shifting to interstate commerce almost the entire burden of supporting state government.[7]

Finally, the questions in this case are substantial because of the danger to interstate commerce that the decision below represents. The decision of the Alaska court is an open invitation to all exporting states, and especially to other

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[7]And Alaska's tax policy is only the latest in the long series of protectionist measures by which Alaska has sought to ensure that no Americans but Alaskans may share fairly in gains related to the resources that Providence has placed in Alaska, even though those gains arise not only from Alaska's resources but from the skills and labor of citizens of all the states. See, e.g., South-Central Timber Development, Inc. v. Wunnicke, 467 U.S. 82 (1984); Zobel v. Williams, 457 U.S. 55 (1982); Hicklin v. Orbeck, 437 U.S. 518 (1978).

resource-rich states, to follow Alaska's example. It gives carte blanche to states to tailor their taxes to impose unapportioned levies on income from the state's principal export, even though interstate businesses must pay taxes on that same income to the state of sale as well. Unless this Court intervenes, the consequence of the Alaska court's decision will be multiplication of taxes on interstate commerce, and an increasing threat to the historic Commerce Clause policy of free interstate trade.

I. THE OIL TAX IS INVALID BECAUSE PRODUCTION INCOME OF APPELLANTS' UNITARY OIL BUSINESSES IS PROPERLY SUBJECT TO APPORTIONMENT AMONG MANY STATES AND MAY NOT BE ATTRIBUTED ENTIRELY TO ALASKA.

The broad purpose of the Commerce Clause is to make sure that interstate commerce is not penalized merely because it is interstate. An enterprise doing business in only one state necessarily exposes no more than 100% of its income to taxation. In comparison to such an intrastate enterprise, an enterprise doing business in two or more states will be disfavored economically if the states in which the enterprise does business become entitled collectively to tax more than 100% of its income. This Court has historically recognized that a state tax is unconstitutional as an undue burden on interstate commerce if it causes the taxpayer to be subjected to multiple taxation.[8]

The danger of multiple taxation in this case is not merely theoretical. The Oil Tax is contrary to the method of taxing oil production income by apportionment which this Court endorsed in *Exxon v. Wisconsin,* 447 U.S. 207 (1980). The result, as might be expected, is actual double taxation of appellants' production income, as well as a direct conflict with the settled law of this Court that a state may not

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[8]Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 446-47 (1979); Evco v. Jones, 409 U.S. 91, 93-94 (1972); Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 462-63 (1959); Michigan-Wisconsin Pipe Line Co. v. Calvert, 347 U.S. 157, 170 (1954); J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307, 311-12 (1938); Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 255-56 (1938).

attribute to itself for taxation 100% of something other states are entitled to tax by apportionment.[9]

A. The Oil Tax Is Inconsistent with This Court's Decision in Exxon v. Wisconsin.

In *Exxon v. Wisconsin,* 447 U.S. 207 (1980), Justice Marshall held for a unanimous Court that the production income of a unitary oil business was subject to taxation by apportionment in all states where the corporate taxpayer operated. This Court rejected the contention that because a "separate accounting" approach might assign all production income to the state where the wells were located, that state had an exclusive right to tax production income from those wells. On the contrary, said this Court, when more than one state has a nexus to production income, such income must be apportioned among all states with the requisite nexus:

> "[T]here is nothing 'talismanic' about the concept of situs for income from exploration and production of crude oil and gas. . . . Presumably, the States in which appellant's crude oil and gas production is located are permitted to tax in some manner the income derived from that production, there being an obvious nexus between the taxpayer and those States. However, 'there is no reason in theory why that power should be exclusive when the [exploration and production income as distinguished through separate functional accounting] reflect[s] income from a unitary business, part of which is conducted in other States. In that situation, the income bears relation to benefits and privileges conferred by several States. These are the circumstances in which apportionment is ordinarily the accepted method.'
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> "... The geographic location of ... raw materials does not alter the fact that such income is part of the unitary business of the interstate enterprise and is

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[9]Appellants do not contend that three-factor apportionment, or any other particular formula, is constitutionally required. The space the Alaska court devotes to the supposed deficiencies of the UDITPA formula is knocking down a strawman. App. 15a-20a. The problem is not that Alaska fails to use standard three-factor apportionment, but that it does not apportion at all.

subject to fair apportionment among all States to which there is a sufficient nexus with the interstate activities of the business." 447 U.S. at 229-30. (Brackets and internal quotes in original.)

Alaska concedes, and its Supreme Court found, that each of the appellants is a unitary business. R. 14836; App. 15a. This case is thus the converse of *Exxon v. Wisconsin.* Wisconsin, a state with no producing wells, sought to apportion to itself a slice of Exxon's production income attributable to wells in other states; Alaska, where producing wells are located, seeks to keep for itself all of the production income from those wells. In *Exxon v. Wisconsin,* this Court upheld Wisconsin's claim to a fairly apportioned share of the taxpayers' production income from wells in other states; the decision in *Exxon,* as the Court has said, "*required* an apportionment of the tax based on the portion of the activity properly viewed as occurring within each relevant state." *Merrion v. Jicarilla Apache Tribe,* 455 U.S. 130, 158 n.26 (1982). Alaska and Wisconsin cannot both be right. Given the right of Wisconsin and other states to tax a share of appellants' production income from Alaskan wells, Alaska's claim to all of it must be rejected.

B. The Oil Tax Results in Actual Double Taxation of Interstate Commerce.

Since appellants are unitary businesses, the decision in *Exxon v. Wisconsin* gives all states where appellants operate the right to tax a share of their production income from selling oil from Alaskan wells in the Lower 48 states. Not surprisingly, most states do so, and the Oil Tax thus causes actual multiple taxation.[10]

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[10]In the case of Exxon, for example, the record shows that not only Wisconsin but 42 other states actually tax a share of Exxon's production income from Alaskan oil: those states treat a total of 30% of that income as "their" income, in addition to the 100% that Alaska says is "its" income. App. 406a-407a. The result is that 130% of Exxon's production income from Alaskan crude (or 30% more than Exxon's actual earnings) is being taxed somewhere. The same is true for the other appellants. App. 381a, 370a.

Multiple taxation of production income from Alaskan oil may also be measured in a somewhat different manner. Sohio, the smallest and least complex of appellants, conducted an elaborate study that demonstrated that

The kind of double taxation found in this case is particularly dangerous to interstate commerce since Alaska's tax is carefully tailored to its principal export, oil. If Alaska may attribute to itself for taxation 100% of the income resulting from sale in other states of oil extracted in Alaska, every other state may do the same for *its* favorite export. Michigan may allocate to itself 100% of income from the manufacture and interstate sale of automobiles. California may claim 100% of the income from the production and interstate sale of wine. Pennsylvania may do the same for steel; Florida for oranges; West Virginia for coal; Kansas for wheat; Oregon for lumber; and so forth. Yet the other states, the states of sale, will also be entitled to levy taxes by apportionment and thus to tax a share of that same income. Adoption by all 50 states of Alaska's notion that a state has a right to tax 100% of the income from production and interstate sale of its principal export, even though other states tax that same income by apportionment, would necessarily result in the multiple taxation of interstate commerce. The principle of Alaska's tax thus cannot be sustained without violating the fundamental policy of the Commerce Clause.

C. The Long-Established Law of This Court Recognizes That Where One State Is Entitled to Tax by Apportionment, No Other State May Tax by Allocating 100% of the Activity to Itself.

For over eighty years, this Court has recognized that a state may not tax 100% of something that other states are entitled to tax by apportionment, and has regularly invalidated state taxes that contravene that principle.[11] The his-

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Sohio was actually taxed in all states on 120% of its Alaska-taxed income in 1978, 123% in 1979 and 111% in 1980, and that, if all states in which Sohio was taxable had exercised their full taxing power, all states would have taxed between 149% and 171% of Sohio's Alaska-taxed income. The results of this study were submitted to the Alaska courts in the affidavit of E. Wayne Tanner, which is set forth in full at p. 380a of the Appendix.

[11]Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 446-47 (1979); Standard Oil Co. v. Peck, 342 U.S. 382, 384 (1952); Central R. Co. v. Pennsylvania, 370 U.S. 607, 613-14 (1962); J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307, 311-12 (1938); Union Refrigerator Transit Co. v. Kentucky, 199 U.S. 194, 210-11 (1905).

toric rule applicable to this case was stated clearly by Justice Blackmun for the Court in *Japan Line*:

> "In order to prevent multiple taxation of interstate commerce, this Court has required that taxes be apportioned among taxing jurisdictions, so that no instrumentality of commerce is subjected to more than one tax on its full value. The corollary of the apportionment principle, of course, is that no jurisdiction may tax the instrumentality in full. 'The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile. . . . Otherwise there would be multiple taxation of interstate operations.' The basis for this Court's approval of apportioned property taxation, in other words, has been its ability to enforce full apportionment by all potential taxing bodies." 441 U.S. at 446-47 (citations omitted).

Again, in *Mobil v. Vermont,* 445 U.S. 425 (1980), this Court reiterated that "taxation by apportionment and taxation by allocation to a single situs are *theoretically incommensurate,* and if the latter method is constitutionally preferred, a tax based on the former cannot be sustained." 445 U.S. at 444-45. In that case, this Court based its decision allowing apportioned taxation of dividend income on the conclusion that the state of commercial domicile could not validly assert the right to tax 100% of that income.

Recognizing the overriding dangers of multiple taxation, moreover, this Court has been careful throughout its history to balance its gradual expansion of the power of states to tax by apportionment with corresponding restrictions on the power of other states to make multiple taxation inevitable by taxing 100% of something this Court has said is subject to taxation by apportionment.[12] Recognition of the right of

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[12]E.g., compare Pullman's Palace Car Co. v. Pennsylvania, 141 U.S. 18 (1891) (allowing property tax on apportioned fraction of railroad cars running through Pennsylvania) with Union Refrigerator Transit Co. v. Kentucky, 199 U.S. 194 (1905) (forbidding tax by Kentucky on 100% of value); compare Ott v. Mississippi Valley Barge Line Co., 336 U.S. 169 (1949) (allowing for the first time apportioned taxation of vessels) with Standard Oil Co. v. Peck, 342 U.S. 382 (1952) (forbidding states, despite

nonproducing states to tax production income by apportionment, upheld in *Exxon v. Wisconsin,* necessarily implies a limitation on the claim of a producing state to tax all of it.

D. The Oil Tax Cannot Be Justified By The Alaska Court's Spurious Distinction Between "Separate Accounting" And "Specific Allocation."

The Alaska court in effect conceded that after *Exxon v. Wisconsin* Alaska could not validly allocate to itself 100% of appellants' production income from Alaskan oil. App. 35a. The court nevertheless purported to justify the Oil Tax on the basis that Alaska's tax was "separate accounting," not "specific allocation," and that the constitutional rules set out in *Exxon v. Wisconsin, Mobil v. Vermont,* and *Japan Line* did not apply to "separate accounting." App. 35a.

With all respect to the Alaska court, its notion that *Exxon v. Wisconsin* did not involve "separate accounting" is exceedingly eccentric. This Court's opinion made plain that the income at issue was Exxon's "exploration and production income as distinguished *through separate functional accounting,*" 447 U.S. at 229; the claim this Court rejected was precisely that "separate accounting" should be used to attribute all production income to the states where the wells were located.[13] See 447 U.S. at 218-19, 222-23, 223 n.7, 226, 229-30; see also *Wisconsin Dep't of Revenue v. Exxon Corp.,* 281 N.W.2d 94, 107-109 (Wis. 1979).

More fundamentally, the Alaska court's purported distinction is without constitutional substance. To accept it would trivialize the Commerce Clause and reduce to a game of labels the historic policy favoring free interstate trade.

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prior contrary law, from taxing 100% of value of vessels domiciled there); compare Standard Pressed Steel Co. v. Washington Department of Revenue, 419 U.S. 560 (1975) (allowing tax on interstate sales if "apportioned exactly to the activities taxed") with J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307 (1938) (unapportioned tax on interstate sales impermissible); see also Braniff Airways, Inc. v. Nebraska State Board, 347 U.S. 590 (1954) (limiting unapportioned taxation of air commerce to situations where no state has a right to tax by apportionment).

[13]Alaska's lawyers acknowledged this point unequivocally when they withdrew Alaska as amicus curiae on a brief filed with this Court in support of Wisconsin. R. 16549.

This Court has repeatedly held that constitutional inquiry under the Commerce Clause must be directed not to the label given by the state, but to the "practical effect" of the tax. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). The Alaska court, however, did not look at the facts. It treated the issue as purely one of law, as to which the label given by the Legislature was controlling. It ignored entirely the taxpayers' careful factual showing that the Oil Tax in fact attributed to Alaska all of the taxpayers' interstate oil production income, and that the result was actual multiple taxation.

The failure of the Alaska court to consider the way in which the Oil Tax actually works is especially astonishing since the supposed distinction the Alaska court was making — that between "separate accounting" and "specific allocation" — is, at best, a very fine one.[14] Despite the constitutional significance it attached to the distinction, the Alaska court was forced to concede that what it called "the separate accounting methodology" was "very similar" to the "specific allocation approach." App. 8a-9a. Indeed, the court's opinion was at several points self-contradictory,[15] and reflected the Alaska court's inability to explain consistently the crucial distinction it said it was making.

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[14]Neither the Alaska Attorney General nor the Alaska Department of Revenue believes in the distinction their Supreme Court drew between separate accounting and allocation. On March 3, 1981, the Attorney General told Governor Hammond that "[d]irect *allocation — sometimes called separate accounting* — is a method by which specific items of income . . . are attributed to specific states." R. 16191. The Department recently acknowledged that "*Allocation* is the term generally used to describe the direct assignment of income or expense unrelated to the corporation's regular business to the state within which the income or expense has its source. This *is commonly called the separate accounting method*." Alaska Department of Revenue, Alaska Taxation — Policy and Structure 25 (1985).

[15]Thus, at App. 9a, the court said that separate accounting "looks to the activities in the state and seeks to determine the income related to that activity," while specific allocation "attributes income according to situs, or some other specific characteristic of the business enterprise, rather than on the basis of where the income itself was earned." At App. 28a, however, the court says that "under the separate accounting approach, income is viewed as earned when and where the principal operating activity occurs," and that "[s]upport activities are universally accounted for only as expenses, whether they occur in or outside the income-producing state."

The Alaska court itself exposed the fallacy of its approach at the only point where it dealt with the facts. In holding that the Oil Tax was "separate accounting," the court relied principally on its assertion that "the Oil Tax does not attribute income from the production of oil *in its entirety* to Alaska." App. 10a. But the list the court gave of the deductions that Alaska allowed, App. 10a, n. 16, is precisely to the contrary, and shows just what the taxpayers claim — namely that under the Oil Tax *all* net income from production of oil from Alaskan wells is attributed to Alaska.[16] Even under the Alaska court's definition, that makes the Oil Tax "situs allocation," not "separate accounting," and invalid.

Equally remarkable was the Alaska court's attempt to save the Oil Tax by proposing that the appellants should do what the federal securities laws forbid. In March, 1982, nine months after the Oil Tax had been repealed, the Department of Revenue made an effort to pretend that a small portion of interstate oil production income had been excluded from Alaska's tax. The Department did so by issuing a regulation that purported to allow, as part of a deduction for general and administrative costs, "a reasonable amount of profit, if

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[16]Thus the court noted that refining and marketing income are omitted in calculating production income under the Oil Tax. This is beside the point, since the question the court claimed to be addressing was whether the Oil Tax attributes all interstate oil *production* income to Alaska, App. 10a, and since production income *by definition* does not include refining and marketing income. (Although the court's statement that refining and marketing income are not included *as production income* under the Oil Tax is literally true, the Court omits to add that the Oil Tax also taxes, by apportionment, appellants' worldwide refining and marketing income. AS 43.21.040.) The court also listed a number of *costs* that are deductible. App. 10a, n. 16. This, too, proves nothing. No one contends that the Oil Tax is a tax on gross receipts. On the contrary, it is a *net income* tax. Costs are therefore deductible — again, *by definition*. The only relevant question is whether, after deduction of costs, the Oil Tax attributes 100% of the *net* production income to Alaska. The court's own calculation shows that it does.

The Alaska court's contrast of the figure of $26.64 in "total revenue" and $6.77 in "net production profit" shows the same confusion. App. 5a, 10a. The first figure represents gross receipts (and includes refining and marketing income to boot); the latter is *net* production income. The court's example thus concedes what appellants assert — that their net production income is 100% attributed to Alaska.

any, that is *actually allocated* to general overhead and administrative activities *for purposes of reporting that year's* earnings and profits *to stockholders."* 15 AAC 21.290(b). The new regulation was, of course, quite limited in scope; it did not even purport to allow attribution of profit to sales outside Alaska, to operating costs incurred in other states, to development expenses incurred in other states, or to anything other than general overhead expenses. Even as to overhead, moreover, the new regulation was a sham. It was carefully designed so that no taxpayer could take advantage of it. First, although the Department's new regulation applied only if the taxpayers had attributed profits to overhead in making their annual reports to shareholders, the regulation was issued only *after* annual reports for all the tax years in issue had already been sent.[17] Second, generally accepted accounting principles ("GAAP") do not allow the attribution of profit to overhead, App. 154a n.2, App. 282a, and appellants, as public companies, are required to prepare their annual reports in accordance with GAAP. 17 C.F.R. § 210.4-01(a)(1). It would thus have been legally improper for appellants to report to their shareholders in the way the new regulation suggested.[18]

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[17]The Alaska court's response to this problem, its suggestion that since the regulation was "retroactive" appellants could amend "their tax reports and returns," App. 12a, simply missed the point. Amending the tax return is not the difficulty; the difficulty is that the regulation allows a deduction only if profits *were actually allocated* to overhead on appellants' annual reports. Those reports, as Alaska well knew, *had already been issued* when the regulation was promulgated. The regulation in force prior to that time, like the Oil Tax itself, allowed deduction only of general overhead *expenses*, not of any profit attributable thereto. AS 43.21.020(c)(9); compare Register 69, April 1979, 15 AAC 12.290(b) with Register 81, April 1982, 15 AAC 21.290(b); App. 282a-283a.

[18]The Alaska court's discussion of this issue, App. 11a, suffered from its failure to deal with the most relevant SEC materials. These provide that financial statements not prepared in accordance with GAAP are "presumed to be misleading or inaccurate." 17 C.F.R. § 210.4-01(a)(1). This regulation, in varying forms, has been in existence since 1938. See Accounting Series Release No. 4, 11 F.R. 10913 (April 25, 1938), Accounting Series Release No. 150 (December 20, 1973), Accounting Series Release No. 280 (September 2, 1980). The Alaska court chose instead to discuss the "other criteria" language of 15 U.S.C. § 78m(b)(2)(B)(ii), and to imply that this language permitted the filing of annual reports not in accordance with GAAP. The

The Alaska court simply failed to come to grips with the central facts of this case. Appellants are unitary businesses; as Justice O'Connor has observed, "The net income of an organic, unitary business . . . is indivisible." *ASARCO, Inc. v. Idaho State Tax Commission,* 458 U.S. 307, 333 n.1 (1982) (dissent). Crude oil from Prudhoe Bay is sold in the Lower 48, and activities in the Lower 48, as well as in Alaska, are required in order for the crude oil to be produced. The net income from production and sale of Alaskan crude oil is necessarily attributable, in part, to *all* of those states, as the unitary business concept recognizes.[19] The Oil Tax, however, refuses to attribute any part of the income to any state other than Alaska, and thereby inevitably produces double taxation. Loose talk about "separate accounting" or "specific allocation" cannot change how the Oil Tax works or remove the double taxation it causes. Labels do not alter facts.

II. THE OIL TAX IS INVALID BECAUSE IT TAXES VALUES EARNED OUTSIDE ALASKA.

A second basic constitutional principle applicable to interstate taxation is that a state may not impose a tax on "values earned outside its borders." *Container Corp. v. Franchise Tax Board,* 463 U.S. 159, 164 (1983); *ASARCO, Inc. v. Idaho State Tax Commission,* 458 U.S. 307, 315

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cited section, however, was enacted in 1977 as part of the Foreign Corrupt Practices Act; its point was not, as the Alaska court mistakenly thought, to allow deviations from GAAP in reporting to shareholders, but to require *additional* internal auditing controls to make sure that financial statements prepared in accordance with GAAP accurately reflect a company's operations. See S.Rep.No. 95-114 (95th Cong., 1st Sess.) at 7-8; 1977 U.S. Cong. & Adm. News 4104-05 (1978).

[19]Alaska understands this concept well enough when it is in Alaska's interest to do so. In cases where production is primarily from wells outside Alaska, the state has repeatedly argued, and the Alaska Supreme Court has held, that production income cannot be separately accounted for by multistate oil companies because it forms an integral part of their unitary income. See State v. Amoco Production Co., 676 P.2d 595, 599-600 (Alaska 1984); Earth Resources Co. v. State, 665 P.2d 960, 968 (Alaska 1983); R. 12836-38. In Sjong v. State, 622 P.2d 967 (Alaska 1981), Alaska identified the contributions of the state of sale as the most important factor in apportioning 92% of a Washington-based crab fisherman's income to Alaska, when the only contact with Alaska was delivery of his catch to Alaskan ports.

(1982); *Connecticut General Life Ins. Co. v. Johnson*, 303 U.S. 77, 80-81 (1938). The Oil Tax violates this principle as well.

A. The Oil Tax Is an Unapportioned Tax on Interstate Sales.

Appellants' net production income is derived virtually in its entirety from interstate sales of crude oil: it represents the difference between the sales price received for the crude oil in the Lower 48 states, and the costs — incurred both in Alaska and elsewhere — of producing that oil and transporting it to the refinery where it is sold. A state, of course, may levy a tax on such sales; it may do so, however, only if the tax is "fairly apportioned." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977); *Evco v. Jones*, 409 U.S. 91, 93-94 (1972). Alaska has failed to apportion.

In *J. D. Adams Mfg. Co. v. Storen*, 304 U.S. 307 (1938), an unapportioned tax indistinguishable from Alaska's was ruled unconstitutional as applied to interstate sales. That case involved a tax on gross income received by Indiana businesses.[20] The taxpayer manufactured road machinery in Indiana for sale to customers throughout the United States and abroad; 80% of its production was sold to customers outside of Indiana. This Court held that the tax was unconstitutional as applied to income from interstate sales.[21] To

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[20]It is now settled that there is no difference for constitutional purposes between gross income and net income taxes. Moorman Mfg. Co. v. Bair, 437 U.S. 267, 280-81 (1978); Armco Inc. v. Hardesty, 52 U.S.L.W. 4787 (June 12, 1984). Nor has the distinction made in some of the early cases between gross receipts taxes and income taxes survived the demise of the distinction between direct and indirect taxes on interstate commerce. See Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977); Washington Dep't of Revenue v. Ass'n of Washington Stevedoring Cos., 435 U.S. 734 (1978).

[21]"The vice of the statute as applied to receipts from interstate sales," the Court said, "is that the tax includes in its measure, without apportionment, receipts derived from activities in interstate commerce; and that the exaction is of such a character that if lawful it may in substance be laid to the fullest extent by States in which the goods are sold as well as those in which they are manufactured. Interstate commerce would thus be subjected to the risk of a double tax burden to which intrastate commerce is not exposed, and which the commerce clause forbids. We have repeatedly held that such a tax is a regulation of, and a burden upon, interstate commerce prohibited by Article I, § 8 of the Constitution." 304 U.S. at 311-12.

the same effect are *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434 (1939), *Michigan-Wisconsin Pipe Line Co. v. Calvert*, 347 U.S. 157, 170 (1954), *Evco v. Jones*, 409 U.S. 91 (1972), and *Washington Dep't of Revenue v. Ass'n of Washington Stevedoring Cos.*, 435 U.S. 734, 749 n.18 (1978).

To be sure, this Court has sometimes allowed a destination state to impose a tax on income from interstate sales, on the theory that the tax was in fact apportioned to the commerce taxed. Never, however, has this Court allowed an *origin* state, like Alaska, to impose an unapportioned tax on interstate sales. For constitutional purposes, crude oil is plainly no different from the road machinery involved in *J.D. Adams* or the apples involved in *Gwin, White & Prince v. Henneford*. The Oil Tax makes no more effort at apportionment of income from interstate sales than did Indiana in *Adams* or Washington in *Gwin*. What is relevant is that the taxpayers' interstate production income comes from interstate sales of crude oil and that Alaska, an origin state, purports to tax all of it without apportionment. This Court has forbidden taxes of that sort for forty years.

B. There Is No Proportion Between the Oil Tax's Measure of Taxable Production Income and Appellants' Contacts with Alaska.

Even if the Oil Tax were apportioned, this Court's cases require that an apportioned tax "actually reflect a reasonable sense of how income is generated," *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 169 (1983), so that the income attributed to the state is not "out of all appropriate proportion" to the taxpayer's in-state activities. *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123 (1931).[22]

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[22] As the Court said in the *Hans Rees* case:

> "[The] decisions are not authority for the conclusion that where a corporation manufactures in one State and sells in another, the net profits of the entire transaction, as a unitary enterprise, may be attributed, regardless of evidence, to either State. In [*Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920)], it was not decided that the entire net profits of the total business were to be allocated to Connecticut because that was the place of manufacture, or, in [*Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*, 266 U.S. 271 (1923)], that the

The extent of the disproportion created by Alaska's decision to attribute to itself all interstate oil production income from Alaskan wells may readily be seen by comparing Alaska's taxes with the standard three-factor formula. The latter has become, as this Court has said, "something of a benchmark against which other apportionment formulas are judged" because "payroll, property, and sales appear in common to reflect a very large share of the activities by which value is generated." *Container Corp. v. Franchise Tax Board,* 463 U.S. 159, 170, 183 (1983). By that standard, overtaxation here ranges from 279% to 804%[23] as compared with the overtaxation of 250% found to be "out of all appropriate proportion" in *Hans Rees,* or the overtaxation of between 162% and 205% that was sufficient to invalidate the apportionment formula in *Norfolk & Western Ry. Co. v. Missouri State Tax Comm'n,* 390 U.S. 317 (1968).[24]

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entire net profits were to be allocated to New York because that was the place where sales were made." 283 U.S. at 132-33.

The effect of the Oil Tax is to attribute to Alaska the "net profits of the entire transaction" — the taxpayers' entire income from pumping oil from the ground in Alaska and selling it in other states. That is just what this Court, in *Hans Rees,* said cannot be done. Yet the Alaska court upheld that attribution not only "without evidence" but in the teeth of the evidence presented in this record, which showed that 90% of the sales and 80% of the expenses that generated the production income occurred outside Alaska. App. 294a, 335a, 285a.

[23]The three-factor formula would have attributed to Alaska only 9.4% of Arco's income, R. 12699; the Oil Tax thus resulted in an overtaxation of Arco's income of 804% on a federal taxable basis and 389% on a book basis. That is, the percentage of Arco's income actually taxed (an average of 85% on a federal taxable basis, R. 13744-46) was 904% of the 9.4% properly taxable under the benchmark formula, or 804% greater than it should have been. The same is true for the calculation on a book basis; both calculations correspond to the method of measuring overtaxation used in *Container,* 463 U.S. at 184. Comparable calculations for Sohio show that the Oil Tax resulted in an overtaxation of Sohio's income of 279% to 342%. R. 13450-51, 13459. Substitution of the Oil Tax for the standard three-factor formula increased Exxon's tax by 326%. R. 293.

[24]The enormous variance between the Oil Tax and the three-factor formula confirms, moreover, that the Oil Tax cannot stand after *Exxon v. Wisconsin.* The two methods of taxation unquestionably produce results out of all appropriate proportion *to each other.* It follows that either Wisconsin was wrong in using the three-factor formula to tax production income, or Alaska is wrong in using the Oil Tax. Since the first alternative is foreclosed by *Exxon v. Wisconsin,* it is Alaska's tax that must give way.

Alaska's own studies confirm that no reasonable apportionment formula could come anywhere near assigning to Alaska the amount of income allocated to Alaska by the Oil Tax. Alaska's Commissioner of Revenue testified that his department did its best to devise an apportionment formula that would generate as much money for the state as the Oil Tax did.[25] Despite the Department's best efforts, it failed. No "reasonable" formula it could devise could produce more than 50% of the income generated by the Oil Tax. Williams Deposition at 57-58; also R. 16187-88. It would be difficult to imagine more dramatic proof that the Oil Tax was out of all proportion to any income properly taxable by Alaska.

III. MULTIPLE TAXATION IS PRESENT HERE AND IS THE CONSTITUTIONAL FAULT OF ALASKA.

A. Decisions Approving Apportionment Do Not Justify the Oil Tax.

The Alaska court attempted to justify the Oil Tax on the basis of this Court's decisions in *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978), and *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983). Both of those decisions, however, upheld *apportionment*, not separate accounting. Neither can justify Alaska's insistence on attributing to itself 100% of interstate oil production income properly subject to apportionment among many states. Indeed, this Court said in *Container* that when a unitary business has contact with more than one state, each taxing state "must then apply a formula apportioning the income of that business within and without the State." 463 U.S. at 169. Alaska has not apportioned here.[26]

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[25]Williams Deposition at 52-61 and Exhibits 87, 94; also R. 16187-88. In Container Corp. v. Franchise Tax Board, 463 U.S. 159, 183, this Court explained that the showing of disproportion in *Hans Rees* was based on comparison with an "analysis purposely skewed to resolve all doubts in favor of the State." Appellants have made an equally compelling showing of disproportion by comparing the Oil Tax with the apportionment formula that the Alaska Department of Revenue itself had designed to be "skewed . . . in favor of the State."

[26]Particularly wide of the mark was the Alaska court's reading of *Container*, a case having to do with the intersection of domestic and *foreign* taxation, as justifying unapportioned taxation by an American state. The

The Alaska court was equally wrong in believing that *Moorman* controlled this case. *Moorman* dealt with a situation where the state effected an apportionment and where there was no proof of *actual* double taxation. 437 U.S. at 276. In that context, the case held that the mere *risk* of multiple taxation caused by one state's use of an apportionment formula different from another state's formula was not sufficient to invalidate either formula. 437 U.S. at 277. *Moorman* has nothing to do with this case, since the record here shows *actual* double taxation. See pp.11-12, *supra*.

Even if the analysis of *Moorman* were applicable, moreover, *Moorman* makes clear that a state's method of apportionment will only be upheld, even assuming no actual double taxation, if the *risk* of double taxation is "not the fault, in the constitutional sense" of the taxing state. The Alaska court paid its respects to this rule by acknowledging that the validity of the Oil Tax depended on a finding that the double taxation caused by the Oil Tax was not constitutionally "the fault" of Alaska. App. 41a. But the court below ignored the evidence showing that Alaska is indeed at fault.

B. Multiple Taxation Is the "Fault" of Alaska Because the Oil Tax Is Unapportioned, Is Tailored to Interstate Commerce, And Is Internally Inconsistent.

In the first place, it is clear that an unapportioned tax renders a state at "fault." The practical basis of *Moorman* is the fact that "rough approximation" is inherent in the

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Commerce Clause, of course, does not apply abroad. When this Court is faced with an unapportioned foreign tax that causes double taxation, as happened in both *Japan Line* and *Container*, it cannot invalidate the foreign tax, as it would a similar state tax. This Court can do one of only two things: either it can restrict the ordinary right of American states to tax by apportionment, or it can tolerate some double taxation. In *Japan Line*, the Court did the former, in *Container* the latter. And in *Container* the Court explained the difference between the two cases by saying that "the reasons for allocation to a single situs that often apply in the case of property taxation 'carry little force' in the case of income taxation," 463 U.S. at 188. Apportionment, in other words, is *more* favored in income tax than in property tax situations, and unapportioned taxes less so. In *Japan Line*, however, it was conceded that the unapportioned foreign tax would have been invalid if levied by an American state. *Container* necessarily implies that Alaska's unapportioned Oil Tax, being on income, is even *more* vulnerable to constitutional challenge than the *concededly* invalid property tax levied by Japan.

concept of apportionment. 437 U.S. at 273. This Court made clear in *Japan Line, Ltd. v. County of Los Angeles,* 441 U.S. 434, 455 (1979), that in *Moorman* "the problem arose, not from lack of apportionment, but from mathematical imprecision in apportionment formulae." *Moorman* has no application, as Justice Blackmun said for the Court, "where true apportionment does not exist." 441 U.S. at 455.[27]

Second, the apportionment formula upheld in *Moorman* was one of general applicability, which covered all, or virtually all, taxpayers in the state. When an apportionment formula is generally applicable, this Court can have some confidence that the normal pull and haul of the political process will result in rough justice for everyone, that the formula involves no discrimination against interstate commerce as such, and that the formula responds only to the inevitable difficulties of trying to divide the essentially indivisible income of a unitary business.

Not so here. The Oil Tax is not a generally applicable enactment. It falls only on interstate businesses, and only on Alaska's principal export. For all practical purposes it is a special levy on the three appellants in this case. As this Court said in *Complete Auto Transit,* "A tailored tax, how-

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[27]Considerations of a proper federalism reinforce this conclusion. If the legislature of a state has recognized, by enacting an apportionment formula, that it must share a particular subject of taxation with other states also entitled to tax that subject, it is hard for a court to articulate and apply a standard for saying that one apportionment formula is better than another. Even if the simultaneous existence of conflicting formulas creates some possibility of multiple taxation, the difficulty of finding a neutral basis for preferring one formula to another means that a court cannot easily determine which of the conflicting formulas is "at fault." 437 U.S. at 277.

None of these considerations applies, however, when a state seeks, like Alaska, to levy a tax on 100% of a subject matter that other states are entitled to and do tax. Not only is double taxation certain in such a case, but there is no difficulty in ascertaining, in a perfectly neutral fashion, which of the states is at fault: obviously it is the state that has made double taxation certain by trying, despite the rights of other states, to allocate a taxable subject matter exclusively to itself. Little deference is appropriate for a state that refuses to share. On the contrary, the mutual accommodation among states that lies at the heart of American federalism is strengthened by enforcing a rule that requires states to take account, in designing their tax systems, of the legitimate and competing rights of other states.

ever accomplished, must receive the careful scrutiny of the courts to determine whether it produces a forbidden effect . . . ." 430 U.S. at 289 n.15. Whatever judicial deference may ordinarily be afforded to an apportionment formula, deference is inappropriate when a state has tailored its tax to raise revenue from a specific interstate business or a specific group of interstate taxpayers. In that situation careful scrutiny, not deference, is required. *Ibid.*

Finally, this Court pointed out in *Moorman* that the risk of double taxation was not inherent in either apportionment formula; it could "be avoided by the adoption of any uniform rule." 437 U.S. at 277 n.12. While the Oil Tax was in place, Alaska's tax system was different: even if it had been adopted by all 50 states, it would have produced double taxation by subjecting appellants' *total* income to more than 100% taxation. Alaska thus violated the constitutional requirement of "internal consistency": the requirement that a tax "must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business income being taxed." *Container Corp. v. Franchise Tax Board,* 463 U.S. 159, 169 (1983); *Armco Inc. v. Hardesty,* 52 U.S.L.W. 4787 (June 12, 1984).[28]

There can be no dispute in this record that, throughout the period the Oil Tax was in force, Alaska's tax laws were

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[28]Affidavits filed in the Superior Court showed that if all states adopted Alaska's laws, more than 100% of the total book income of each taxpayer would have been taxed in each year in issue — e.g., in 1980, the states would have taxed 160% of Exxon's total income, 116% of Arco's, and 162% of Sohio's. R. 13455, 13746, 14207. The reason that Alaska's tax system, if applied by all 50 states, would inevitably have produced more-than-100% taxation is readily understood. If a taxpayer had wells in Alaska, under the Oil Tax Alaska taxed 100% of the taxpayer's production income from Alaskan oil, as well as an apportioned share of the taxpayer's refining, marketing, and other income. AS 43.21.040. If, however, a taxpayer had no producing wells in Alaska, Alaska applied apportionment to the taxpayer's *total* income, including not only refining, marketing, and other income but *also* oil production income arising from wells in states other than Alaska. AS 43.20; App. 408a. If all states had used the Alaska system, the production states together would have taxed 100% of production income. The other states where a taxpayer operated would also have taxed, by apportionment, a share of that same production income. And all states would have used apportionment to divide up refining and marketing income. The necessary result would have been more-than-100% taxation of total income.

applied in exactly this manner. The Director of the Division of Audit of the Alaska Department of Revenue, the responsible state official, so testified. App. 408a. The double taxation of appellants caused by the Oil Tax in those years was unmistakably the result of a tax system that was internally inconsistent, and therefore "at fault" under *Moorman*.[29]

IV. THE MEASURE OF ALASKA'S TAX IS NOT REASONABLY RELATED TO APPELLANTS' CONTACTS WITH ALASKA.

In *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981), this Court considered the claim that Montana's severance tax on coal violated the Commerce Clause because the amount of the tax was not reasonably related to the value of the services provided by the state. The Court rejected the taxpayer's claim of invalidity, holding that the question was not whether the *amount* of the tax is reasonably related to the services provided by the taxing state, but whether the *measure* of the tax is reasonably related to the taxpayer's contacts with the state. 453 U.S. at 626.

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[29]After the repeal of the Oil Tax and the close of all the tax years in issue, and following the filing of appellants' papers in the Superior Court which showed that Alaska's tax laws were internally inconsistent, Alaska unveiled a "Tax Ruling" that purported to modify retroactively the way Alaska taxed companies, unlike appellants, that did *not* have wells in Alaska. Alaska chose, in effect, to pretend that it had applied its tax laws differently than was in fact the case. This "ruling" was transparently no more than a piece of litigation strategy, intended to defeat the internal inconsistency argument and save the Oil Tax by giving small refunds under a different tax. This disingenuous administrative afterthought cannot, however, defeat appellants' constitutional claims. Those claims are based on the double taxation that was caused by the Oil Tax between 1978 and 1981; the relevance of the internal consistency test is to help this Court determine whether Alaska, or some other state, was responsible for the double taxation occurring in those years. Alaska's tax system, as it applied in the years when the double taxation occurred, did not and could not meet the internal consistency test. It follows that Alaska, not the other states, was responsible for the double taxation, and that Alaska, not the other states, was "at fault."

In any case, the internal consistency test would lose much of its practical meaning if it assumed that all states will adopt Alaska's priorities by abandoning the use of apportionment to tax oil production income. They plainly will not. Rather, they will conform their own versions of the Oil Tax to whatever is *their* principal export and tax other industries, such as oil, by apportionment. See p. 12, *supra*.

Montana's was a severance tax. The "operating incidence" of that tax, this Court held, was "on the mining of coal within Montana," 453 U.S. 626. The "operating incidence" of Alaska's tax, however, is not on the extraction of oil, but on the earning of income, and specifically on the earning of income from the sale in other states of oil from Alaskan wells. The activities that result in that income take place in many states, and the income is subject to tax in many states.

The measure of Alaska's tax, however, is not related to the income-producing activities that take place in Alaska. It makes no difference if a taxpayer alters its business so that more, or less, of that business is done in Alaska.[30] However the taxpayer's business may be organized in fact, the Act allocates to Alaska 100% of the taxpayer's production income from Alaskan oil. The measure of the tax is not proportioned in any way to the quantity of business that is done in Alaska, and the Oil Tax cannot pass muster under *Commonwealth Edison.*

V. THE OIL TAX IMPROPERLY DISCRIMINATES AGAINST APPELLANTS AND PROVIDES A DIRECT COMMERCIAL ADVANTAGE TO LOCAL ALASKA INTERESTS.

There is no room for dispute as to what the Oil Tax does on its face: it singles out a handful of interstate oil companies for significantly different and more burdensome treatment than that accorded all other corporate taxpayers. As Alaska's Governor acknowledged in his first Budget Message after the Oil Tax Act was passed, "there is no question but that oil has been taxed unequally compared to other resources." R. 15010. In recent years, this Court has been especially vigilant to protect interstate commerce against taxes that involve economic protectionism and unfair treat-

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[30]The Appendix contains a careful analysis, by Sidney Davidson, Arthur Young Professor of Accounting and former Dean of the Business School at the University of Chicago, of the consequences of a taxpayer's altering its business operations to shift activities into or out of Alaska. App. 158a.

ment of out-of-state business.[31] Examination of the Oil Tax shows plainly that it has forbidden effects.

To start with, there is the obvious fact that the Oil Tax provides a direct commercial advantage to local interests by throwing on interstate commerce alone the task of satisfying Alaska's appetite for funds, and freeing Alaska's citizens from the responsibility of paying for the services they enjoy. The facts on this point are set out in the Statement of the Case, are examined in detail in the Mieszkowski Affidavit, App. 172a, and need not be repeated again here.

In addition, the effect of the Oil Tax is to subject interstate business to a discriminatory burden of double taxation. An oil company with all its operations in Alaska will pay tax on the basis of 100% of its production income at most. A company operating in more than one state must pay taxes on 100% of its production income to Alaska, and must pay additional taxes on that same income to other states. Once again, the relevant facts have been set out above. They are discussed in detail by Professor Davidson, who shows that the Oil Tax results in a *continuing* tax advantage for local firms. App. 164a.

Finally, the Oil Tax operates to penalize exploration outside Alaska.[32] Alaska has thus used its "power to tax an

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[31]Such taxes may offend both the Commerce Clause and the Equal Protection Clause. Bacchus Imports, Ltd. v. Dias, 52 U.S.L.W. 4979 (June 29, 1984); Armco Inc. v. Hardesty, 52 U.S.L.W. 4787 (June 12, 1984); Westinghouse Electric Corp. v. Tully, 466 U.S. —, 52 U.S.L.W. 4485 (April 24, 1984); Metropolitan Life Insurance Co. v. Ward, 53 U.S.L.W. 4399 (March 26, 1985).

[32]A firm subject to the Oil Tax that drills a well outside Alaska may not deduct the cost of doing so on its Alaska return. If the well is drilled in Alaska, however, the cost of drilling it is deductible. 15 AAC 21.270. Alaska's tax thus creates a penalty if a taxpayer subject to the Oil Tax Act drills a well in any state other than Alaska. If, on the other hand, a taxpayer is not subject to the Oil Tax (because it has no producing wells in Alaska) and its income is taxed by three-factor apportionment, Alaska interprets the Oil Tax as requiring the exclusion of all exploration losses from the apportionable base. App. 411a, 412a, 420a. The effect of these provisions can easily be seen to be discriminatory if one follows this Court's teaching by applying the internal consistency test of Armco Inc. v. Hardesty, 52 U.S.L.W. 4787 (June 12, 1984), to Alaska's tax laws. If all states enacted Alaska's laws, each state where a taxpayer has production income would tax under the Oil Tax and

in-state operation as a means of 'requiring other business operations to be performed in the home State.' " *Boston Stock Exchange v. State Tax Comm'n,* 429 U.S. 318, 336 (1977). Like the tax in *Westinghouse Electric Corp. v. Tully,* 466 U.S. — , 52 U.S.L.W. 4485 (April 24, 1984), the Oil Tax violates "the prohibition . . . against using discriminatory state taxes to burden commerce in other states in an attempt to induce 'business operations to be performed in the home state that could more efficiently be performed elsewhere' and to 'impose an artificial rigidity on the pattern of an industry.' " 52 U.S.L.W. at 4490.

CONCLUSION

This is an important case which raises substantial federal questions. The Court should note probable jurisdiction and set the matter for full briefing and argument.

November 13, 1985

Respectfully submitted,

[Counsel Listed on Following Page]

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would allow deduction only of exploration losses in that state; states where the taxpayer has no production income would tax by apportionment and would allow no deductions for exploration losses at all. The effect of universal application of Alaska's laws therefore is to make the cost of drilling a well in a state where a taxpayer has no producing wells more expensive than the cost of drilling in a state where a taxpayer has production. The obvious consequence is to channel exploration activities into states that already have oil, and away from states that might compete with them if oil were found.

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